

Introduction to Marketable Securities

Marketable securities refer to the securities that are actively traded in recognized markets, where they may be readily valued, purchased or sold. Specifically, marketable securities include common and preferred stocks, U.S. Government securities, corporate bonds, municipal securities, mutual funds and cash management instruments. The relative liquidity of these instruments generally allows the trustee to convert them into cash more readily than other types of investments.

A savings association should thoroughly research and analyze a marketable security prior to making a decision to purchase, retain or sell it. Investment research may be performed internally or be provided by external research firms. There is no requirement that a savings association perform its own research and no prohibition against hiring an external firm to provide investment advice. No matter what method is used, the process should be fully detailed in the trust department's policies and operating procedures and all investment decisions should be supported by research material and analysis. An important aspect of the process is the ability to identify exceptions to the policy. Reasons or corrective action for such exceptions should be fully documented and monitored. Failure to do so will increase the risk profile of the savings association.

As trustee, a savings association may become invested in a large number of individual securities (stocks, bonds, mutual funds etc.). It may be highly inefficient to research and analyze each of these securities. Therefore, many trust departments have developed "approved lists" of securities to facilitate the process of investment management. The use of this list reduces the number of security holdings in discretionary accounts that are not actively followed by asset management personnel. If such lists are used, policies should specify the individuals having authority to make additions or deletions to the list. Appropriate personnel and/or committees should closely monitor the list and any changes resulting from current research should be considered, reviewed and approved. Finally, procedures should exist to monitor actual investment decisions made for compliance with the approved list.

Appropriate personnel should periodically conduct a review of all marketable securities held by fiduciary accounts. The review should consider financial data relevant to both the specific entity and the industry. The records of the savings association must document the reviews performed and the conclusions reached.

Presented below are some of the more commonly accepted advantages relative to the different types of marketable securities, followed by a list of some of the factors which should be considered prior to making an investment decision regarding the use of these securities. While the advantages are discussed separately, one of the most significant advantages is their use together. A portfolio, which is diversified with a mix of securities, will assist in minimizing the risk of large losses and account fluctuations.

Common and Preferred Stocks: The use of common stock in a fiduciary account's investment portfolio offers a number of advantages in terms of meeting investment objectives. One, income from dividend payments may be sufficient to cover a beneficiary's need for current income. Two, capital appreciation could increase the total value of the portfolio for the remainder beneficiaries. Three, for accounts that are not tax-exempt, any capital gains are in most cases taxed at a lower rate than ordinary income. Four, trading stocks on the open market results in easier and more efficient trading compared to other types of investments. Finally, holding stocks allows a portfolio manager to exercise "secondary" or additional investment strategies such as writing covered call options or equity swaps, which may increase the account's yield,

without substantially increasing the risk. The following is a partial list of the factors that should normally be considered in making an investment decision pertaining to common and preferred stocks:

- Quality and depth of company management
- Financial condition of the company, including its position in the industry
- Quality of earnings, both current and historical
- Future prospects, both for the company in terms of competition, growth, sales, etc.
- Impact upon the company of any anticipated legislation or any government, management, or labor activities
- Ability of the company to develop, upgrade and/or market products to expand into new lines of business
- Ratings received by financial rating services
- Opinions rendered by accountants on financial statements
- Impact of any pending or existing litigation

Debt Securities: Debt securities include U.S. Government and agency obligations, corporate bonds and notes and commercial paper. U.S. Government and agency obligations offer advantages of quality, security, stability of income, marketability and elimination of credit and liquidity risk. Corporate obligations offer the advantages of being senior in liquidation of stocks, general stability and regularity of income. In addition, since they are issued with varying maturity dates, their use allows a portfolio manager to ladder maturities to achieve investment goals and reduce interest rate risk. Commercial paper of large corporations provides an alternative to short-term Treasury bills and is often used for investing temporary funds for up to one year. Their advantage is greater when short-term yields are high and uncertainty is present in the market. The following is a partial list of factors to be considered when making decisions regarding investments in debt securities:

- Quality and depth of management
- Capitalization of the company, including consideration of the trend of capital expenditures and nature of the industry
- Issuer's earning power and income projections
- Ability of the issuer to repay
- Rating received from financial rating services
- Rate of interest
- Maturity and yield to maturity
- Present and future marketability of the issue

In addition, special types of debt securities may require consideration of other factors. For example, public utilities will require a consideration of the probability of rate increases, the effect of increased fuel costs and the effects of anticipated changes in demand.

Municipal Securities: The biggest advantage to state and municipal securities has been their exemption from federal income taxes. Beneficiaries in high income tax brackets have found these investments to be attractive. The following is a partial list of the factors to consider in making investment decisions pertaining to municipal securities:

- Sufficiency of actual and anticipated tax revenues to cover present and anticipated debt service
- Power and ability of the taxing authority to levy sufficient taxes to cover the debt service requirements
- Assessed property valuations and their relationship to tax burden
- Projected growth of tax base
- Historical trend of debt
- Budget considerations or constraints of the municipality
- Cash flow requirements
- Accuracy of past estimates of revenues and expenses

As with corporate debt, other special types of municipal securities may require additional considerations.